

BUSINESS LAW SECTION

CORPORATIONS COMMITTEE

COMMITTEE MEETING MINUTES FOR MARCH 1, 2002

**Friday, March 1, 2002
Sacramento**

A regular meeting of the Corporations Committee (the "Committee") of the Business Law Section of the State Bar of California was held at The State Capitol Building in Sacramento. Attendance was as follows:

MEMBERS PRESENT:

Keith Paul Bishop
David S. Caplan
Nelson D. Crandall
Bruce Dravis
James K. Dyer, Jr
Teri Shugart Erickson
James F. Fotenos
Steven K. Hazen

Brian D. McAllister
Ethna M. Piazza
David M. Pike
Randall B. Schai
James R. Walther
Daniel J. Weiser
Nancy Wojtas

MEMBERS ABSENT:

John C. Carpenter
Timothy J. Fitzpatrick
Mark T. Hiraide
Carol K. Lucas
Eileen Lyon
B. Keith Martin
Cynthia Ribas
Neil J. Wertlieb

LIAISONS PRESENT:

Timothy Le Bas, Department of Corporations
Betsy Bogart, Secretary of State
Waldeep Singh, Secretary of State
Pamela Giarrizzo, Secretary of State
Todd Vlaanderen, Secretary of State

GUESTS PRESENT:

Terry Miller, Legislative Office of the State Bar
Gloria Ochoa, Assistant Chief Counsel, Senate Judiciary Committee

The minutes summarize discussions primarily in the order items were listed on the Agenda for the meeting previously circulated to members of the Committee, which is not necessarily the order in which the items were actually taken up at the meeting. The Committee did not take up those topics listed on the Agenda, which are not described in these Minutes.

I. ADMINISTRATIVE MATTERS.

A. Opening Remarks and Announcements. The meeting was brought to order by Co-Chair James Walther at approximately 9:30 a.m. Mr. Walther asked members and guests to introduce themselves. Mr. Walther then noted that the April 5, 2002 meeting of the Committee will be held by videoconference, with locations at Mayer, Brown, Rowe & Maw in Palo Alto and Milbank, Tweed in Los Angeles. Mr. Walther also stated that the Business Law Section Spring Meeting will be held May 17-19 in La Costa.

B. Approval of Minutes of February 1, 2002 Meeting. Members had comments on the draft minutes of the meeting of the Committee held on February 1, 2002 and previously circulated. Mr. Pike will revise and submit the minutes for final approval with next month's meeting package.

II. LIAISONS' REPORTS AND DISCUSSION.

A. Department of Corporations. Timothy Le Bas, Assistant Commissioner of the Department of Corporations, reported on recent activities of the Department of Corporations.

He noted that the Department is currently analyzing the following bills now in the state legislature: AB1875 (short-form dissolution), SB399 (entity conversions) and AB2187 (changes to Section 25102(o) regarding options issued by publicly traded companies).

Mr. Le Bas also summarized the following regulatory packages that have been submitted by the Department for public comments:

- Amendments to the California Code of Regulations ("CCR") to allow all applications, amendments and fees filed by broker-dealers and agents under the California Corporate Securities Law of 1968 ("CSL") to be filed directly with the Central Registration Depository. The comment period ends April 2, 2002.
- Amendments to the CCR to provide that all applications, amendments, reports, notices and fees filed by investment advisers and investment adviser representatives under the CSL may be filed with the Investment Adviser Registration Depository. The comment period ends March 4, 2002.
- Amendments to Section 260.204.9 of the Commissioner's Rules under the CSL to exempt from the provisions of Section 25230 any person (i) who does not hold itself generally to the public as an investment adviser, (ii) has fewer than 15 clients, (iii) is exempt from the Federal Investment Advisers Act of 1940 and (iv) either has assets under management of not less than \$25 million or provides investment advice only to venture capital companies. These regulations are being filed with the Office of Administrative Law today. Under the Administrative Procedures Act, the Office of Administrative Law has 30 days to review the proposed rules. If approved, this will be submitted to the Secretary of State for filing. Normally, regulations take effect 30 days after filing with the Secretary of State, but the Department has requested that they take effect on filing.

Mr. Le Bas also reported that amendments to Title 10, Sections 260.102.19, 260.140.41, 260.140.42, 260.140.45 and 260.140.46 of the CCR become effective on March 9, 2002. In addition, Mr. Le Bas reported that the Department has submitted an invitation for comments with respect to revised Title 10, Sections 260.140.41, 260.140.42, 260.140.45 and 260.140.46 of the CCR pertaining to securities qualification standards for employee, director and consultant option and purchase plans. The comment period ends April 26, 2002.

Further, Mr. Le Bas reported that the Department is preparing to adopt as regulations application forms for finance lenders. The Department intends to adopt these regulations as emergency regulations. These regulations will also include a form of short-form application for licensees that wish to obtain licenses for additional locations under the Finance Lenders Law.

Mr. Le Bas also reported that the Department has proposed some technical revisions to SB399, which was included in the meeting package for this meeting.

Mr. Le Bas also commented on the Enron situation and said that he anticipated that several bills will be introduced in the state legislature dealing with companies that misrepresent their financial condition. He stated that a key question is how to maintain the risk of misrepresentation at the level of those entrusted with the financial integrity of reported financials, i.e. officers, directors, attorneys and accountants. He asked that any member of the Committee with comments and/or suggestions contact him directly.

Finally, Mr. Le Bas noted that the Department is working on a pilot program for electronic filing of notices under Section 25102(f).

B. Secretary of State. Betsy Bogart, liaison from the Secretary of State's office, noted that the Secretary of State's web site now has a section with filing tips for a number of corporate filings. She asked that any members of the Committee with comments contact Todd Vlaanderen or her.

Betsy Bogart commented that the expedited pre-clearance process for corporate filings is being used on a regular basis.

Waldeep Singh, Manager of the Business Programs Automation Project of the Secretary of State's office, presented a report to the Committee regarding the Secretary of State's Business Programs Automation Project and distributed to the Members a copy of the executive summary for the project. Mr. Singh noted that the project has received final approval and he is working with various interested groups to get feedback as the project moves forward. He suggested that the Committee establish a liaison group to interface with the Automation Group on a periodic basis. Mr. Walther requested that any members of the Committee interested in serving on the liaison committee contact him directly. Mr. Waldeep further reported that periodic updates with respect to the status of the automation project will be posted on the Secretary of State's web site. He also said that members of the Committee with questions or comments concerning the automation project should contact him at wsingh@ss.ca.gov.

C. Cyberspace Committee. Ethna Piazza reported that she did not have anything new to report and said that she would contact the Cyberspace Committee to determine what activities that committee is currently involved in.

D. Partnerships and LLC Committee. Steven Hazen reported on the activities of the Partnerships and LLC Committee. The committee met last month and John Camozzi has been appointed as the new Chairman of the Committee. Mr. Hazen also reported that the Guide to Limited Liability Companies prepared by the committee has been completed and delivered to the State Bar. Mr. Hazen said that he would distribute copies of the Guide to members of the Committee. Mr. Hazen also said that the committee discussed the "junction box" approach to entity conversions and suggested that Chip Lyon make a presentation to this Committee concerning this approach to entity conversion. Finally, Mr. Hazen noted that he is also participating in an ad hoc group of attorneys and accountants monitoring recent and proposed activities of the FASB arising out of the Enron situation and which could have a significant impact on the use of LLCs as special purpose entities in financing transactions such as synthetic leasing. Mr. Hazen requested that members of the Committee interested in receiving information concerning the work of this ad hoc group send him an email and he will add their names to the distribution list for the group.

E. UCC Committee. Jim Dyer reported that the UCC Committee met last month and is meeting again next week. He reported that the model control agreement (relating to taking a security interest in deposit accounts) is about to be published.

III. PENDING LEGISLATION/AFFIRMATIVE LEGISLATIVE PROPOSALS.

A. Report of Legislative Liaison. Mr. Fotenos reported that the Committee's proposed legislation to amend Section 710 of the Corporations Code had been introduced by Senator Romero as SB1472. Mr. Fotenos also reported that Senator Flores has introduced AB2969 which would amend existing law that provides an exemption from state usury provisions for evidences of indebtedness issued by an entity or affiliated guarantor entity that has total assets of at least \$2 million according to its most recent financial statements. The financial statements are required to meet specified requirements, including being prepared (1) in accordance with generally accepted accounting principles and, if the entity has consolidated subsidiaries, on a consolidated basis, and/or (2) in accordance with the rules and requirements of the Securities Exchange Commission. Since enactment, a debate has arisen whether these requirements were intended to be conjunctive or disjunctive (neither "and" nor "or" appears in the statute.) This bill would clarify the financial statements are required to meet one of the above requirements, rather than both of those requirements.

B. SB399 (corporate conversions). Mr. Walther reported that Mr. Werlieb met with the Insolvency Committee last month regarding whether the proposed notice provision under SB399 is necessary. Mr. Walther further reported that he and Mr. Wertlieb spoke with members of the Executive Committee and that committee had decided to reconsider whether it may be advisable to object to the notice provision and then withdraw support of the Business Law Section for the bill if the Senate Judiciary Committee insists upon a notice provision. Given the Executive Committee's approach to SB399, members discussed how best to proceed. Mr. Walther suggested that it may be advisable to ask the Executive Committee to reconsider its decision but stated that any decision by the Corporations Committee should be deferred until next month when Mr. Wertlieb is in attendance so that he can report on his discussions regarding this proposed legislation.

C. Section 25102(o) Emergency Regulation Comments. Mr. Bishop distributed to the members of the Committee a draft legislative proposal for a blanket exemption for option grants to employees and others. The Committee noted that the Department of Corporations has circulated a request for comments regarding the current stock option rules. Mr. Bishop advised the Committee that the Los Angeles County Bar Association is also developing proposed amendments to Section 25102(o) that would allow the exemption to be available to companies that do not qualify for an exemption under Section 25102(o) because they are '34 Act reporting companies. This is a problem for option plans adopted by reporting companies that are not otherwise exempt from California securities law qualification requirements due to not being listed on the NYSE, AMEX or Nasdaq National Market. Members discussed whether it is better to focus on amending the existing stock option rules through the Department of Corporation's request for comments procedure or to propose new legislation that would delete many of the existing stock option rules altogether. Members agreed to continue to review Mr. Bishop's legislative proposal and discuss it at next month's meeting.

D. Section 710 (sunset on supermajority approvals). David Pike confirmed Mr. Fotenos' earlier report regarding the status of the proposed amendment to Section 710 of the Corporations Code.

IV. POTENTIAL AFFIRMATIVE LEGISLATIVE PROPOSALS.

A. Secretary of State Fax Filings. Mr. Dravis summarized the proposed fax signature legislation included in this month's meeting materials, which would add a new Section 17.1 to the Corporations Code defining "signature," "signed," and "executed." Ms. Bogart commented that the use of the word "filer" in Section 17.1(d) is somewhat misleading, since the Secretary of State is actually the filer. It was suggested that it would be preferable to clarify the legislation by referring to the corporation or other entity presenting a document for filing as the one to keep the original signed document. Ms. Bogart also said that the requirement in Section 17.1(d) that the filer maintain the originally signed document for at least five years from the date of signing, might be better if changed to five years from the date of filing, since there can often be a significant time lag between signing and filing a document. She also stated that proposed Section 17.1(c) which requires documents with facsimile signatures to be presented for filing in person, by mail or courier (and does not authorize directing faxes to the Secretary of State) is important to the Secretary of State's Office as a matter of process. Ms. Bogart also mentioned the concern for authentication of the documents.

Mr. Le Bas commented that the Department of Corporations has enforcement responsibilities and requires original signed documents to prosecute an action. He would like to know how other states handle situations in which a faxed signature is used on the filed document. Ms. Bogart also said that if there is litigation it is more difficult to determine what the true original document is if only a copy with a fax signature is on file with the Secretary of State. Mr. Vlaanderen stated that it is easier to alter a fax or photocopy document than it is to alter an original signed document.

Mr. Bishop said that there are two issues to consider: (i) what does it mean to "sign" a document and (ii) what evidence of signature is required by the government to file a document once it has

been signed. Mr. Bishop said he is concerned about the definition of "signature" and whether it conflicts with the e-sign statute. Mr. Bishop commented that the definition of "signature" in the Corporations Code must either conform to the federal e-sign law or the version of the Uniform Electronic Transactions Act ("UETA") specified in the federal e-sign law. All other definitions of "sign" appear to be preempted under the e-sign law. Gloria Ochoa, Assistant Chief Counsel of the Senate Judiciary of the Committee, noted that Senator Sher has introduced SB97 to conform the UETA to federal e-sign legislation. Ms. Piazza said that she would review SB97 and the e-sign legislation and report to the Committee at a future date. Mr. Fotenos suggested that someone expert in e-sign legislation review the facsimile signature proposal before it is sent to the Executive Committee for final approval.

Mr. Caplan suggested that the facsimile signature on a filed document be deemed to be prima facia proof of a legitimate signature. The burden of proof would be on the person challenging the authenticity of the facsimile signature. This approach would also encourage filers to retain original signatures as evidence in the event that a facsimile signature is challenged. Mr. Hazen agreed with this approach. Ms. Bogart stated that this may solve the issue with the "filer" language and the need for the requirement that documents be retained for five years.

B. 25118(b) Definition of Aggregate Evidence of Indebtedness. Mr. Weiser led a discussion of Section 25118(b), which exempts from the usury provisions certain loans aggregating \$300,00 or more. Mr. Weiser reported that he had spoken with Jerry Grossman, who worked on the original legislation and commented that, at the time the original legislation was adopted, the concern was that small borrowers were being cheated by unscrupulous lenders and there was not much emphasis on larger lending transactions. Now that two years have passed since the original legislation was adopted, it might be a good time to suggest changes. Mr. Weiser said that he would compare other states' approaches to this issue and he would make a presentation at next month's meeting.

C. Amend Corporations Code to permit electronic Communications to Constitute a "Writing." Ms. Piazza reported on proposed amendments to the Corporations Code to permit electronic communications and remote transmission in connection with board and shareholder meetings, consents and notices. Members reviewed and discussed the proposed text of the amendment included in the meeting materials. Ms. Piazza highlighted for the members of the Committee certain portions of the text for closer review and asked that anyone with comments or questions contact her directly.

D. Amend Finance Lenders Law. Mr. Le Bas commented on the finance lenders proposal previously distributed to members of the Committee and other interested parties. He questioned under what conditions would the exemption be granted - what types of loans and from what type of venture capital fund? He also suggested that the definition of venture capital fund be included in the proposed legislation, instead of making a cross-reference to a definition in another section. Mr. Le Bas also noted that the proposed legislation conflicts in that the proposed legislation provides for a good faith defense for potential liability, but the only penalty under the proposed legislation is criminal, which is not subject to a good faith defense.

V. WEB SITE PROJECTS.

A. Recent Developments Page. Ms. Wojtas circulated a summary of recent developments to be included on the Committee's web site.

VI. OTHER PROJECTS.

A. Educational Activities. Mr. Dravis reported he needs volunteers to participate in presentations on (i) corporate law for the non-corporate attorney (which Ms. Erickson will chair) and (ii) Delaware versus California law at the Business Law Section Spring Meeting, May 17-19 at La Costa. Mr. Dravis also said he is seeking volunteers to participate in a panel presentation on the fiduciary duty of directors for the annual meeting of the State Bar in October. Messrs.

Schai and Weiser volunteered to participate in this presentation.

B. Other. Ms. Ochoa summarized new proposed legislation that may be of interest to the Committee, including AB2187 (exemption for certain securities issued pursuant to a purchase plan or agreement), SB1472 (amendment to Corporations Code Section 710) and a bill to be introduced by the L.A. County Bar Association to provide for exemption for options issued by '34 Act reporting companies who are not listed on Nasdaq National Market.

Members also discussed the Enron situation. Mr. Weiser commented that practitioners should look carefully at debt covenants in contracts that define debt according to GAAP as in effect from time to time, because if GAAP is later revised to move off-balance sheet liabilities onto the balance sheet this could result in an immediate and unanticipated breach of debt covenants.

The meeting was adjourned at approximately 12:40 p.m.

/s/ David M. Pike
David M. Pike
Secretary

Corporation Committee Meeting Minutes

